ZIONS BANK | ZBPF | PUBLIC FINANCE

MEMORANDUM

DATE: Wednesday, January 8, 2014

TO: Richard Ellis, State Treasurer
David Damschen, Deputy State Treasurer

FROM: Brain F. Baker
Zions Bank Public Finance

RE: Lincoln Academy Charter School

The purpose of this report is to document Lincoln Academy Charter School's ("Lincoln," "LCS," or the "School") adherence to the eligibility standards created for participation in the Utah Charter School Credit Enhancement Program (the "Program"). The analysis contained herein is based on Lincoln's full application to the State Charter School Finance Authority (the "Authority") as well as additional information and documents submitted in response to follow up requests by the Authority.

The School has provided all information requested subsequent to the submission of the initial application. All questions have been answered to my satisfaction. This report will examine each category of the Program's "Standards for Participation," including Basic Eligibility, Enrollment/Student Demand, Academic Performance, Management, Financial Performance, and Bond Documents. In each of these categories, the School met the basic eligibility requirements for participation in the Program, as detailed below. This report should be examined in direct conjunction with the Letter of Certification for Lincoln Academy from the State Charter School Board ("SCSB Letter"), which provides detailed analysis and historical information on Enrollment/Student Demand and Academic Performance.

Lincoln Academy—Introduction

Lincoln Academy is a K-9 charter school located in Pleasant Grove City. The School received its charter in 2004, and originally served 480 students up through grade 8. Subsequently, the enrollment cap was increased several times to the current level of 865, which anticipates the construction of the new junior high school. Lincoln received approval for its most recent enrollment increase just prior to the beginning of the fall 2013 school year. The School currently has 684 students and a cap of 690, which will increase to 865 next year.

With 96% retention and approximately 369 students on the waiting list, they should be able to obtain full enrollment when the new junior high facility comes online.

Lincoln's focus and mission has remained constant from their original charter application. The mission statement reads:

"To inspire children to love learning and to empower them to explore and achieve their individual potential."

The School is looking to issue approximately $14,875 million in revenue bonds to refinance bonds issued in 2007 for the acquisition of Lincoln's existing facilities (42,500 square feet), and to construct a new 31,000-square foot junior high school. The average interest rate on the 2007 bonds is 6.2%, so debt service savings are expected on the portion of the new bond issue related to the refinancing of the old bonds.

Basic Eligibility

1. Lincoln's 2014 bonds will be issued through the Authority.

2. The SCSB Letter indicates that LCS is in good standing with the State Charter School Board.

3. The School has obtained an investment grade rating of "BBB-" from Standard & Poor's ("S&P"). Key credit concerns from the private rating report are listed below, followed by Zions' response to these concerns :
    a. Elevated debt service carrying charge—this concern relates to the high MADS coverage (26.7%) prior to the opening of the new junior high school, and is offset by the strong demand the School has seen historically.
    b. Construction risk—S&P points out that this concern is mitigated by the GMP (Guaranteed Maximum Price) and the covenant for the contractor to pay for alternative facilities is delays occur.
    c. Growth risk—mitigated by existing demand and waiting list. A 26% increase in enrollment is projected for 2014-2015.
    d. Charter risk—stated as a risk in the report, but not a true risk given the evergreen status of Utah charter school charters.

    S&P also cites the following as positive credit factors that offset the above-listed weaknesses:
    a. Strong operational liquidity of 138 days' cash on hand.
    b. Positive operations on full accrual basis since 2011 and budgeted for 2014.
    c. Steady demand, with waitlist representing 54% of current enrollment, and enrollment at or near charter cap since 2007.
    d. Good academic performance with test scores that exceed state averages.

4. Lincoln Academy has been in operation since 2005. Operational history, as demonstrated by past audited financials, indicate that the School has increased fund balances and cash position and maintained a stable operating margin.

5. The School has a defined and specific mission to "inspire children to love learning and to empower them to explore and achieve their individual potential." The school uses the following four approaches to achieve this: 1. Small student to teacher ratio; 2. Academically challenging and diverse curriculum; 3. Safe, nurturing environment; and 4. Creative, hands-on learning.

6. LCS issued bonds in 2007 which will be refinanced by the 2014 bonds. Lincoln is not in default under its existing bonds.

Enrollment/Student Demand

7. The School has 643 students enrolled this year.

8. Since 2008, Lincoln has operated with more than full enrollment. Over that time period Lincoln has not seen a drop of enrollment year over year. Table 1 from the SCSB Letter includes detailed enrollment history back to 2009.

9. Lincoln Academy exceeds the re-enrollment standard established by the SCSB in each of the past three years. The most recent total re-enrollment rate of 88.3%, coupled with the school's strong historical track record, indicate admitted students are generally staying through the final available grade. Table 2 from the SCSB Letter details historical enrollment and re-enrollment.

10. The School exceeds the ADM rate requirement. Over the last three years, LCS's Average Daily Membership rate has been 99.9%, 99.2%, and 99.4%.

11. The School has provided wait list statistics by grade, and has provided the detailed waiting list that includes descriptive and personal information on potential students to the Deputy State Treasurer. The current waiting list is strong, particularly for the elementary grades. It is anticipated that the new junior high school facility will increase demand and thus the wait list.

Academic Performance

12. The SCSB Letter indicates that the School meets required academic standards. Table 3 from the SCSB Letter provides a breakdown of Lincoln Academy's performance relative to other schools. The 2013 UCAS score of 468 is above the state average of 427. The State Charter Board approved new goals in July 2013 that the School seems on track to meet.

Management

13. The School has adopted reasonable management policies and practices that guide financial, debt, and risk management. The Board has adopted an acceptable Succession Plan as well as a Financial and Risk Management Plan. The post-issuance compliance section of this plan could include a few more specific actions related to compliance.

14. Lincoln Academy has a diverse and stable Board with staggered terms. Though no board member possesses specific legal experience or background, there is clear expertise in management, marketing, education, and technology.

15. The Administration handles all financial matters relative to the School's operations. Marie Eads has served as Lincoln's business manager for the past 6 years and has demonstrated that she has the training, experience, and track record to perform these duties.

16. Lincoln Academy's historical budgeted revenues and expenditures generally demonstrate "reasonable proficiency" in forecasting. The School saw expenditures come in 6.3% lower than projections in 2013 based on the capitalization of a $150,000 kitchen remodel expense that the School budgeted for but the auditors capitalized under full accrual accounting.

Financial Performance

The School meets all of the current requirements for the Financial Performance section of the application.

17. Projections used by the School in financial forecasting appear reasonable. The WPU is grown at 2% versus expenses at a lower 1.9%, but once Lincoln meets its growth target in the 2015 year, there is sufficient flexibility in the proforma that these minor differences are inconsequential. The School appears to be in a healthy financial position.

18. Debt Coverage Ratio

Requirement	Measure	Sufficient?
At least 110%	111%	Yes

Debt coverage ratio is calculated by dividing total revenues available for debt service by the maximum annual debt service payment anticipated for the new bonds. Revenues available for debt service is calculated by taking fiscal year 2013 net income from operations of $267,892 and adding back depreciation expense of $297,017 and interest expense of $575,603. This leaves net revenues available for debt service of $1,140,512. When this number is divided by anticipated maximum annual debt service of $1,026,625, the coverage is 111%.

For the past three years, this performance has been consistent. Coverage is anticipated to increase to 132% by the time the School begins making the making the maximum annual debt service payment in 2016, subsequent to the anticipated increase in student enrollment..

	2013	2012	2011
Net Income Available for Debt Service	$1,140,512	$1,129,719	$1,279,627
Maximum Annual Debt Service	1,026,625	1,026,625	1,026,625
Debt Coverage Ratio	111%	110%	125%

19. Debt Burden Ratio

Requirement	Measure	Sufficient?
Less than 25%	24.9%	Yes

The debt burden ratio requirement is based on the level of the School's fund balance, which we calculate at 35% (cash of $1,346,433 divided by total operating expenses net of depreciation of $3,850,839). Debt burden ratio is calculated as maximum annual debt service ($1,026,625) divided by unrestricted operating revenues ($4,118,731), taken from 2013 audited financial statements.

	2013	2012	2011
Maximum Annual Debt Service	$1,026,625	$1,026,625	$1,026,625
Unrestricted Operating Revenues	4,118,731	4,036,303	4,099,188
Debt Burden Ratio	24.9%	25.4%	25.0%

The School debt burden relative to actual existing debt was 18% each of the past three years. We consider Lincoln's ability to meet the required standard in 2013 relative to an increased debt burden designed to be funded by future growth a sign of strength, and view the table above as demonstrating substantial compliance with this requirement.

20. Operating Margin

Requirement	Measure	Sufficient?
At least 7%	28%	Yes

Lincoln Academy's operating margin requirement of 7% or greater is based on the calculation for days cash on hand (calculated as cash divided by operating expenses multiplied by 365) of 128 days. Operating margin of 28% is calculated by dividing net income available for debt service of $1,140,512 (see calculation under Debt Coverage Ratio) by total revenues of $4,118,731.

	2013	2012	2011
Net Income Available for Debt Service	$1,140,512	$1,129,719	$1,279,627
Revenues	4,118,731	4,036,303	4,099,188
Operating Margin	28%	28%	31%

21. Current Ratio

Requirement	Measure	Sufficient?
At least 150%	253%	Yes

The current ratio is defined as current unrestricted assets ($1,375,117 for 2013) divided by current liabilities ($544,184). The School has exceeded a 150% current ratio each of the last two years, but did not in 2010 or 2011 due to the cash purchase of a house adjacent to the School used to house students.

Lincoln Academy	2010	2011	2012	2013
Current Assets	$620,771	1,016,520	1,228,865	1,375,117
Current Liabilities	443,697	855,732	556,679	544,184
Current Ratio	140%	119%	221%	253%

Bond Documents

20-23. LCS's legal bond documents have been reviewed by Chapman and Cutler in their capacity as bond counsel to the Authority, and all requirements have been incorporated. In addition, Ballard Spahr, as bond counsel to Lincoln Academy, has confirmed that each of the required legal provisions is present in the bond documents.